

# MARKETBEAT

## San Diego

### Office Q2 2017



#### SAN DIEGO OFFICE

##### Economic Indicators

	Q2 16	Q2 17	12-Month Forecast
San Diego Employment	1.42M	1.44M	▲
San Diego Unemployment	4.8%	3.6%	▼
U.S. Unemployment	4.9%	4.4%	▼

#### Economy

The San Diego employment market continued to record job growth, adding 20,300 jobs (+1.4%) year-over-year through May 2017. Of the 20,300 jobs added, 3,700 (or 18%) were office jobs consisting of two sectors: professional and business services and financial activities. During the same time period, the unemployment rate decreased 70 basis points (bps), dropping to 3.6%. Last time the unemployment rate was this low was 11 years ago in May of 2006. The current rate is 240 bps below the 27-year average of 6%.

##### Market Indicators (Overall, All Classes)

	Q2 16	Q2 17	12-Month Forecast
Vacancy	15.5%	14.1%	▲
Direct Net Absorption (sf)	200K	95K	▼
Under Construction (sf)	1.4M	1.6M	▲
Average Asking Rent	\$2.79	\$2.93	▲

All employment sectors are expected to grow at a combined growth rate of 1.6% in 2017, according to Moody's Analytics. Office employment is forecasted to record a 2.4% growth in 2017, positively affecting demand for office space. San Diego's economy of \$220.6 billion as measured by gross regional product grew an estimated 3.2% in 2016 - consistent with its 10-year average growth rate of 3.1% - and is forecasted to grow an additional 2.7% in 2017.

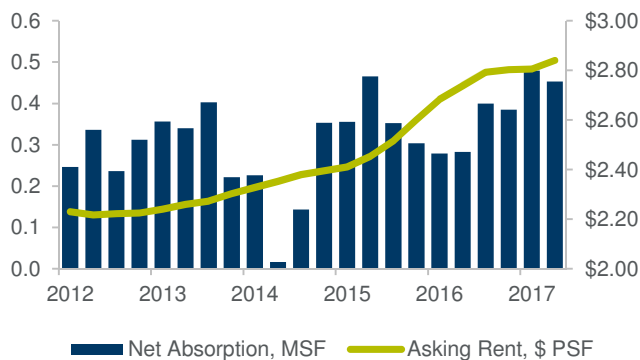
#### Market Overview

Office vacancy (including sublease) decreased to 14.1% in Q2 2017, down 30 bps from last quarter and 140 bps from a year ago. This was the fifth consecutive quarter of decreasing vacancy. Occupancy grew by 95,000 square feet (SF) across all classes in Q2, bringing year-to-date net absorption to 552,000 SF. This was the best year-to-date activity since 2013 (736,300 SF absorbed in Q1 and Q2). Occupancy growth, however, was disproportionate by region as tenants absorbed 85,800 SF across all classes in Central County submarkets, 23,900 SF in South County submarkets, but returned 14,700 SF to North County submarkets. At the end of Q2 2017, overall vacancy was the lowest in South County (10.7%) followed by Central County (14.9%) and North County (16.1%).

\*Rental rates reflect full service asking \$psf/monthly

##### Direct Net Absorption/Asking Rent (Full Service, Monthly)

###### 4-QTR TRAILING AVERAGE



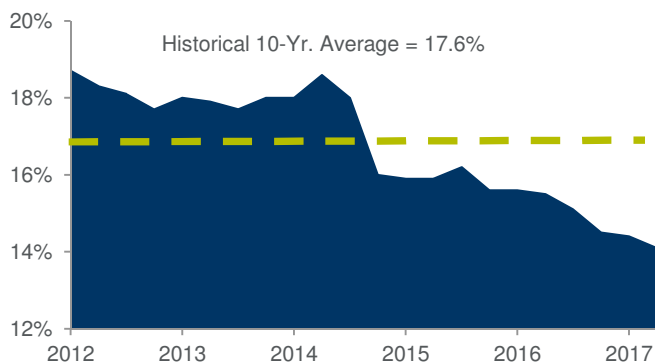
In Q2 2017, Class A overall vacancy was 15.2% countywide, down 40 bps from last quarter and 130 bps from a year ago. Class B overall vacancy was 14.5%, down 30 bps from last quarter and 40 bps from a year ago.

Two buildings totaling 67,600 SF were completed in Q2, bringing year-to-date deliveries total to 555,606 SF.

Absorption in Q2 2017 was driven by a number of mid-sized move-ins. In Kearny Mesa, the County of San Diego occupied their 58,000 SF lease at 3666 Kearny Villa Rd., while AVID moved into 50,000 SF at 9797 Aero Dr. which they purchased earlier this year. In Downtown, 130,000 SF was absorbed across four buildings, including larger tenants like Suntrust Bank and Psyonix. In Chula Vista, Scripps occupied 27,000 SF in a building they purchased. In Torrey Pines, the Medicines Company moved into the completion of its 63,000 SF build-to-suit at Spectrum Lab. However, it has half the space up for sublease.

A number of large leases were signed in previous quarters that will further boost absorption in future quarters as these tenants begin occupying the space. In Rancho Bernardo, Northrop Grumman will expand into another 222,000 SF at Summit Rancho Bernardo. In Eastgate, La Jolla Pharmaceuticals will occupy 78,000 SF at Axiom and ServiceNow will occupy a 64,000-SF building currently subleased by Kratos and Plaza Home Mortgage. In UTC, Wells Fargo signed a 45,000-SF lease at One La Jolla Centre, and One Reverse Mortgage will move into 16,000 SF at Sunroad Corporate Center. In Sorrento Mesa, Certona has a lease to occupy 32,000 SF, and another 40,000 SF will be occupied at The Yard and The Oberlin creative office projects later this year. The California Institute of Arts & Technology signed a lease for 44,000 SF in National City this quarter.

##### Overall Vacancy – All Classes, incl. Sublease





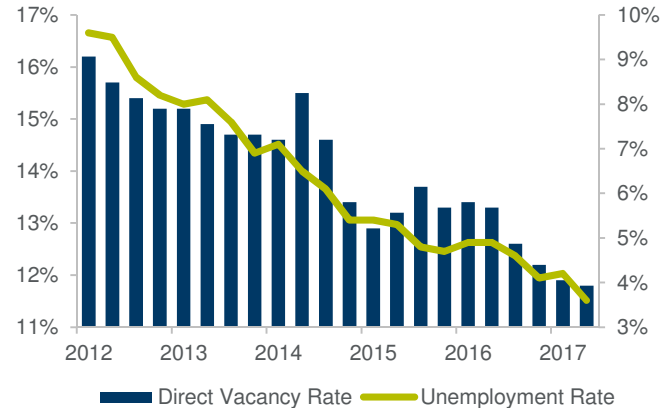
A number of tenants returned significant blocks of space in San Diego County in Q2. Rancho Bernardo returned the most space with Broadcom vacating 82,000 SF in two buildings and Menon International vacating another 32,000 SF in another. The UTC submarket also suffered a number of significant vacancies. Goodwin Proctor's 23,000 SF lease (subleased by WJ Bradley) ended this quarter, and EvoNexus moved out of 23,000 SF but occupied a different building in the same project. One Roof Energy also vacated 18,000 SF in UTC. In Downtown, a number of small to mid-sized tenants vacated 77,000 SF across four buildings.

**Q2 2017 WAS THE 12<sup>TH</sup> CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY**

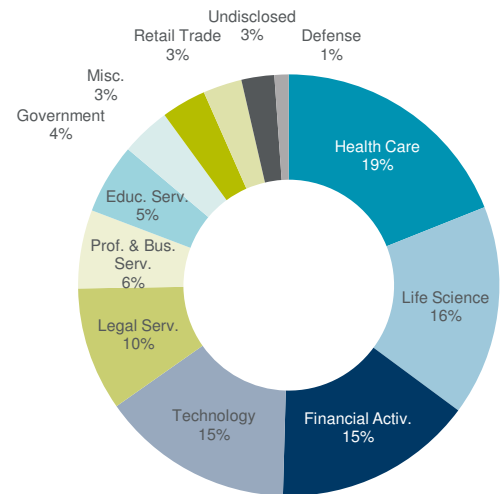
Much of future absorption will come from leases signed for projects currently under construction. After occupying their 295,000-SF campus building in UTC in Q4 2016, Illumina will also occupy 316,000 SF at Biomed Realty's i3 in Eastgate later this year, a positive sign of the impact biotechnology and healthcare companies have on San Diego's economy. ViaSat, which is headquartered and employs nearly 2,000 workers in Carlsbad, is expanding its footprint as well. The company's Bressi Ranch site in Carlsbad is planned for approximately 500,000 SF at build out, with 200,000 SF scheduled to be completed in 2018. Later this year, Renovate America will occupy a 160,000-SF building currently under significant renovation in Rancho Bernardo. In 2018, a 110,000-SF build-to-suit project is expected to be completed for Palomar College. Pima Medical Institute will take 40,000 SF at the Icon@North City project in San Marcos, also later this year. In late 2017, UCSD's 66,000-SF build-to-suit at Park + Market will begin construction. This quarter, Takeda Pharmaceuticals signed a build-to-suit lease for over 163,000 SF in Eastgate.

Of the 18 properties totaling 1.6 MSF currently under construction countywide, 12 are scheduled for completion in 2017. Just under 700,000 SF of inventory under construction are part of build-to-suit projects. Three of the properties under construction are creative office renovations of previously existing buildings, including AMP&RSAND, a 320,000 SF renovation of the old Union-Tribune office and print buildings in Mission Valley and a smaller 34,000 SF renovation of the old San Diego Daily Transcript building in Uptown. Makers Quarter Block D just broker ground in Downtown and is planned to be a hub of sustainable live/work/play lifestyle employment center. Of the total 1.6 MSF of product countywide, 64% already have commitments in place. While we anticipate continued preleasing activity, this will likely result in a modest short-term uptick in vacancy as these projects come online later in the year.

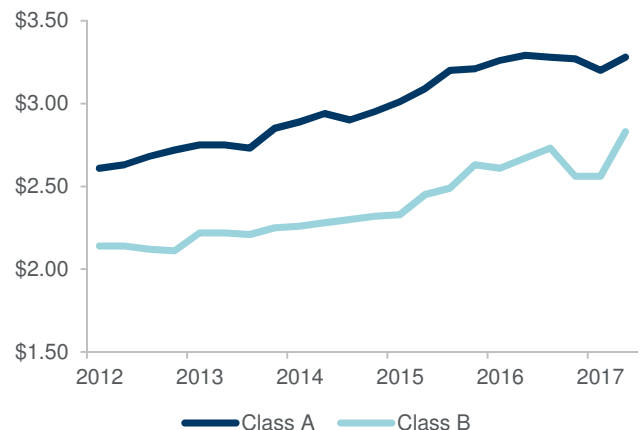
**Direct Vacancy vs. Unemployment Rate**  
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



**Tenant Demand by Industry Type**  
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 50% OF TOTAL DEMAND



**Average Asking Rate by Class (Full Service)**  
CLASS A RENT REMAINED STABLE AND CLASS B INCREASED 6% Y/Y



## Outlook

- Continued economic growth and resulting job growth will drive occupancy and rent growth in 2017. Leasing within the 5,000 to 50,000 SF range will continue to be the main driver of activity, accounting for 54% of total SF in lease obligations set to expire over the next 18 months. Leases 50,000 SF and larger will account for 24% of activity, while leases 5,000 SF and less will account for 22%.
- Active tenant requirements stand at 3.2 MSF over the next 24 months countywide with 2.1 MSF in Central County, 635,000 SF in North County and 500,000 SF in South County. Forty percent of these tenants have yet to send out proposals and are still in the early stages of their search. While not all of the current tenants in the market will transact in the short term, these levels provide a barometer to leasing activity in quarters to follow.

SUBMARKET	TOTAL BLDGS	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT	VACANCY RATE	CURRENT DIRECT NET ABSORPTION (SF)	YTD DIRECT NET ABSORPTION (SF)	UNDER CONSTRUCTION (SF)	AVERAGE ASKING RENT* (ALL Classes)	AVERAGE ASKING RENT* (CLASS A)
North County	341	10,572,075	214,361	1,485,503	16.1%	(14,740)	67,402	308,954	\$2.45	\$2.78
Central County	836	48,907,159	1,394,781	5,908,066	14.9%	85,821	176,370	1,190,181	\$3.10	\$3.45
South County	318	16,964,555	148,482	1,663,379	10.7%	23,907	307,961	106,405	\$2.58	\$2.92
<b>TOTAL</b>	<b>1,495</b>	<b>76,443,789</b>	<b>1,757,624</b>	<b>9,056,948</b>	<b>14.1%</b>	<b>94,988</b>	<b>551,733</b>	<b>1,605,540</b>	<b>\$2.93</b>	<b>\$3.28</b>
Class A	319	32,151,260	945,474	3,947,179	15.2%	30,970	242,955	1,509,090	\$3.28	
Class B	755	33,669,550	730,776	4,153,628	14.5%	134,403	(38,244)	96,450	\$2.83	
Class C	421	10,622,979	81,374	956,141	9.8%	(70,385)	347,022	0	\$1.85	
<b>TOTAL</b>	<b>1,495</b>	<b>76,443,789</b>	<b>1,757,624</b>	<b>9,056,948</b>	<b>14.1%</b>	<b>94,988</b>	<b>551,733</b>	<b>1,605,540</b>	<b>\$2.93</b>	

\*Rental rates reflect full service (FS) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

## Key Lease Transactions Q2 2017

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
17095 Via Del Campo	185,028	Northrop Grumman	Teradata	Renewal	Rancho Bernardo
9625 Towne Centre Dr.	163,648	Takeda Pharmaceuticals	Alexandria Real Estate Equities	New	Eastgate
Pacific Corporate Center	48,709	Qualcomm	Kilroy Realty Corporation	Renewal	Sorrento Mesa
One La Jolla Centre	45,594	Wells Fargo	The Irvine Company	New	UTC
Scripps Corporate Plaza	26,192	Kratos	Cypress Office Properties	New	Scripps

## Key Sale Transactions Q2 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
North Coast Medical Plaza	49,580	Montecito Medical Real Estate	Foley Properties & The Gareeb Family Foundation	\$30,050,000 (\$606/SF)	Carlsbad
Torrey Hills Medical Plaza	44,156	Coast Income Properties	San Diego Comprehensive Pain Management	\$28,500,000 (\$645/SF)	Del Mar Heights
Scripps Wateridge Corporate Center	124,303	HCP	Colony Northstar	\$26,100,000 (\$210/SF)	Sorrento Mesa
Canyon Rim Industrial Park	40,755	CMS Capital Holdings	Washington Capital Management	\$12,500,000 (\$307/SF)	Sorrento Mesa
Eight Governor Park	25,600	Persnickety Painters	Locale Advisors	\$11,200,000 (\$438/SF)	Governor

## Under Construction Q2 2017

PROPERTY	SF	PRELEASED SF	%	ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
AMP&RSAND	318,570	0	0%	350 Camino de la Reina	A	2018	Mission Valley
i3	316,262	316,262	100%	4775 - 4785 Executive Dr.	A	2017	Eastgate
Bressi Ranch	200,000	200,000	100%	Town Garden & El Camino Real	A	2018	Carlsbad
9625 Towne Centre Dr.	163,648	163,648	100%	9625 Towne Centre Dr.	A	2018	Eastgate
Rancho Vista Corporate Center	160,925	160,925	100%	16409 W. Bernardo Dr.	A	2017	Rancho Bernardo
Bernardo Terrace Corp. Center	110,000	110,000	100%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
Torrey Point	88,440	0	0%	3420 - 3430 Carmel Mountain Rd.	A	2017	Del Mar Heights
The Icon @ North City	60,000	40,000	67%	111 Campus Way	A	2017	San Marcos
Makers Quarter – Block D	51,192	0	0%	1501 15 <sup>th</sup> St.	A	2018	Downtown
Aston Point	48,954	0	0%	1800 Aston Ave.	B	2018	Carlsbad
Third Avenews	34,296	0	0%	2131 3 <sup>rd</sup> Ave.	B	2018	Uptown
Westfield UTC	32,336	32,336	100%	4545 La Jolla Village Dr.	A	2017	UTC
Grossmont Summit	13,200	0	0%	9400 Grossmont Summit Dr.	B	2017	East County
IDEA1	7,717	7,717	100%	895 Park Blvd.	A	2017	Downtown

**OFFICE SUBMARKETS**  
SAN DIEGO



**About Cushman & Wakefield**

Cushman & Wakefield is a global leader in commercial real estate services, helping clients transform the way people work, shop, and live. The firm's 43,000 employees in more than 60 countries provide deep local and global insights that create significant value for occupiers and investors around the world. Cushman & Wakefield is among the largest commercial real estate services firms in the world with revenues of \$5 billion across core services of agency leasing, asset services, capital markets, facilities services (branded C&W Services), global occupier services, investment management (branded DTZ Investors), tenant representation and valuations & advisory. To learn more, visit [www.cushmanwakefield.com](http://www.cushmanwakefield.com) or follow @Cushwake on Twitter.

**Jolanta Campion**

Director of Research, San Diego Region  
[jolanta.campion@cushwake.com](mailto:jolanta.campion@cushwake.com)

**Justin Balagtas**

Research Analyst  
[justin.balagtas@cushwake.com](mailto:justin.balagtas@cushwake.com)

4747 Executive Drive, Suite 900  
San Diego, CA 92121  
Tel: 858.625.5235  
Fax: 858.630.6320  
CA License 01880493

Copyright © 2017 Cushman & Wakefield. All rights reserved. The information contained within this report is gathered from multiple sources considered to be reliable. The information may contain errors or omissions and is presented without any warranty or representations as to its accuracy.